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NORTHERN DISTRICT OF CALIFORNIA

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UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA

CW

CV 08 3517

SECURITIES AND EXCHANGE COMMISSION,

Case No. _____

Plaintiff,

vs.

ROBERT C. BROWN, JR. AND TREBOR COMPANY
(AKA TREBOR INVESTMENT COMPANY, TREBOR
SEMINARS, TREBOR GROUP AND TREBOR GROUP
FUND),

PLAINTIFF SECURITIES AND
EXCHANGE COMMISSION'S
MEMORANDUM OF POINTS AND
AUTHORITIES IN SUPPORT OF *EX*
PARTE APPLICATION FOR
TEMPORARY RESTRAINING
ORDER AND ORDER TO SHOW
CAUSE RE PRELIMINARY
INJUNCTION

Defendants,

and

DUANE EDDINGS, CDC GLOBAL, INC. AND WISE
INVESTORS SIMPLY EXCEL, LLC,

Relief Defendants.

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I. INTRODUCTION

Since at least 2000, Robert C. Brown, Jr. ("Brown") and his sole proprietorship, Trebor Company, (collectively, "defendants") misappropriated more than \$20 million from hundreds of investors who believed Brown would invest their money in the stock market. Based on his purportedly proven ability to invest successfully, Brown guaranteed astronomical returns to investors. The vast majority of the money Brown raised, however, was never invested in the stock market. Instead, Brown funneled investors' money into accounts that he controlled. He treated these accounts like personal slush funds, using the money to pay for lavish personal expenses such as repairs for his Ferrari, limousine services, and expensive shopping trips with his girlfriend. Brown also transferred hundreds of thousands of dollars of investor money to his family members. Brown further used money from newer investors to pay so-called "profits" to other, favored investors, whose money Brown never actually invested in securities.

Brown is currently attempting to raise additional money. As recently as June 2008, Brown promised an investor a return of 30% to 40% *per month* on his investment, which Brown purportedly would invest in securities. Brown also promised this investor a 10% commission on all money Brown raises from any individuals referred to Brown by this investor. In addition, Brown is engaging in a new scheme to obtain investor money by instructing investors to open brokerage accounts in their own names and then provide Brown their online user identification and passwords to allow him to trade online in their accounts. Brown is promising to split the profits with investors.

Brown has violated the antifraud provisions of the federal securities laws by misappropriating client assets, making materially false and misleading statements in connection with the purchase or sale of securities, and perpetrating a fraud on his investment advisory clients. Accordingly, to preserve the status quo, and particularly to preserve any remaining investor assets and to halt further solicitations by Brown, the Commission hereby requests that the Court enter a temporary restraining order, an order freezing certain accounts Brown owns and controls, an order requiring defendants Brown and Trebor Company to conduct an accounting, an order requiring defendants Brown and Trebor Company to repatriate to the territory of the United States of

America all assets and funds held by, or in the name of, or for the benefit of Brown and Trebor Company, and finally, other interim equitable relief.

II. STATEMENT OF FACTS

A. The Parties

Defendant Robert C. Brown, Jr., age 55, resides in Hillsborough, California. Declaration of Jeremy E. Pendrey in Support of Ex Parte Application for Temporary Restraining Order and Order to Show Cause Re Preliminary Injunction ("Pendrey Decl."), ¶ 4. He is not registered with the Commission in any capacity. *Id.* at ¶ 5. In investigative testimony taken by the Commission's staff prior to filing the instant action, Brown refused to answer questions about his investment qualifications, Trebor Company, solicitation of investors, his investments, and misappropriation of investor funds based on his Fifth Amendment privilege against self-incrimination. *Id.* at ¶ 2.

Trebor Company is a sole proprietorship owned by Brown and is the name he has used for his investment "group." Pendrey Decl., ¶ 3, Ex.1. (Trebor is Robert spelled backward.) Brown has also used the names Trebor Investment Company, Trebor Seminars, Trebor Group, and Trebor Group Fund (collectively "Trebor Company"). *Id.* at Exs. 3, 7, 16.

Relief Defendant Duane Eddings ("Eddings"), age 48, resides in Vallejo, California. Pendrey Decl., Ex. 32. Eddings was the registered agent for service of process for Wise Investors Simply Excel, LLC and CDC Global, Inc. *Id.* at ¶ 6. Eddings was a member of Wise Investors Simply Excel, LLC and was CDC Global, Inc.'s president. *Id.* at ¶ 6, Ex. 33. He has received more than \$50,000 from Brown. *Id.* at ¶16, Exs. 26, 36. In investigative testimony taken by the Commission's staff prior to filing the instant action, Eddings asserted his Fifth Amendment privilege against self incrimination and refused to answer the staff's questions. *Id.* at ¶ 7.

Relief Defendant Wise Investors Simply Excel, LLC ("WISE") is a California limited liability company based in Vallejo, California. Pendrey Decl., Ex. 32.

CDC Global, Inc. ("CDC") is a California S corporation based in Oakland, California. Pendrey Decl., Ex. 33. WISE transferred over \$240,000 to CDC, and Brown wrote cashier's checks to CDC totaling in excess of \$135,000. *Id.* at Exs. 23, 25, 33.

B. Brown's Fraud**1. Brown Lured Clients With False Profit and No-Risk Claims.**

Starting in at least 2000 and continuing through the present, Brown solicited money from hundreds of investors by holding himself out as an expert investment adviser who had made millions of dollars for himself by trading in the stock market. Declaration of Teresa Bunch in Support of Ex Parte Application for Temporary Restraining Order and Order to Show Cause Re Preliminary Injunction ("Bunch Decl."), ¶ 4, Ex. 1; Pendrey Decl., ¶ 12, Exs. 11-15. Brown told investors that he would invest their money in the "stock market," "stock," or "options." Declaration of William Michael McCombe, Jr. in Support of Ex Parte Application for Temporary Restraining Order and Order to Show Cause Re Preliminary Injunction ("McCombe Decl."), ¶ 4; Bunch Decl. at ¶ 3; Declaration of Patrick Whitfield in Support of Ex Parte Application for Temporary Restraining Order and Order to Show Cause Re Preliminary Injunction ("Whitfield Decl."), ¶ 6.

Brown lured investors with false and misleading promises of high returns and no-risk trading in securities. McCombe Decl., ¶¶ 4-5, 7, Ex. 1; Bunch Decl., ¶¶ 4, 7, Exs. 2, 5, 6, 9, 10, 12; Whitfield Decl., ¶ 6. He repeatedly assured investors that their investments were "guaranteed" and downplayed the potential risks of investing in stocks, telling them that he day-traded stocks and options, and that his method of trading ensured that he could make money in both up and down markets. McCombe Decl., ¶ 5; Whitfield Decl., ¶ 6; Pendrey Decl., Ex. 2 (36:11-20). Brown said that his method of trading was very low risk. *Id.* He even claimed that he had never lost money in the market. McCombe Decl., ¶ 5. Brown told investors that if their investments did not make as much money in the market as he promised, he would pay the difference out of his own pocket. Bunch Decl., ¶ 4; McCombe Decl., ¶ 5. He even told investors that he would pay the taxes on their profits. McCombe Decl., ¶ 5.

Brown offered investors two main types of Trebor Company investment "programs," each one promising phenomenal, guaranteed returns. Bunch Decl., Exs. 2, 5; McCombe Decl., Ex. 1. Brown documented the investments in the programs in written contracts. *Id.* First, starting in 2000, Brown offered a "Quarterly" program, which had variable returns on a quarterly basis, minus unspecified fees. Pendrey Decl., Exs. 3, 11. By 2004, Brown had changed the variable program to a

1 “24-Month High Yield” investment that promised returns of 63-90% per year, with profits to be paid
2 every four months. Bunch Decl., Exs. 2, 5; McCombe Decl., Ex. 1. In certain contracts, Brown
3 would take a 10% fee. Pendrey Decl., Ex. 18.

4 Beginning in 2002, Brown offered “double” agreements where he promised to double investor
5 money in 13 or 14 months, with profits to be paid in a lump sum at the end of the term. Pendrey
6 Decl., Exs. 4, 13, 14. In 2005, Brown offered a new 24-Month “double” agreement whereby he
7 promised that he would match investors’ money with a dollar for dollar “gift” of his own money,
8 thereby instantly doubling their account balance and future returns. Bunch Decl., ¶¶ 6, 8, 12, 13, Exs.
9 5, 9, 12. In 2006, Brown offered yet another “double” agreement that promised he would double
10 investor money in only eight months. Pendrey Decl., ¶ 17, Ex. 27.

11 Brown’s promises to investors were false when he made them. He never invested most
12 investor money, and thus he had no basis to promise any profits, let alone doubling investor money in
13 8, 13, 14 or 24 months. Pendrey Decl., Exs. 10, 24-26, 28-32, 37-43. In addition, Brown treated the
14 money raised from investors as his own and spent their money on personal expenses. *Id.*; McCombe
15 Decl., Ex. 2. Thus, he knew he could not possibly generate the astronomical returns he promised.
16 Finally, Brown used money from newer investors to pay so-called “profits” to other, favored
17 investors, whose money Brown never actually invested in securities. Pendrey Decl., Exs. 10, 24-26,
18 28-32, 37-43. Thus, Brown had to know that the so-called “profits” did not come from his success in
19 the stock market or from any money he could give investors as “gifts” pursuant to a “double”
20 agreement; rather, the purported profits came at the expense of newer investors.

21 A large number of Brown’s investors had little or no prior experience investing in securities
22 and invested with Brown based on his false promises about high returns and no risk. Bunch Decl., ¶¶
23 5, 7; McCombe Decl., ¶¶ 3-5. Moreover, many of these investors did not have sufficient assets to
24 adequately assume the risks of investing in securities. For example, one couple, whose only other
25 investment was approximately \$50,000 in a mutual fund in an individual retirement account (which
26 had been funded through retirement savings accrued working for the state government), invested their
27 entire retirement account and the entire equity in their home, a total of \$300,000, representing their
28 life savings. Bunch Decl., ¶¶ 6-13. After receiving only about \$22,000 in purported profit payments,

1 Brown stopped making any payments to them. *Id.* at ¶¶ 9, 15, 18. These clients repeatedly asked for
2 their money and Brown and Trebor Company frequently assured them that they would be paid. *Id.* at
3 ¶¶ 18-20. Despite these promises, Brown never paid them any further returns on their investment,
4 nor did he return any principal. *Id.* at ¶ 23.

5 Another investor was a phone company lineman who had no other investments (aside from
6 his 401(k) retirement account) and who was eager to make extra money in order to provide primary
7 care for his two children as well as to three nieces and nephews. McCombe Decl., ¶¶ 2-3. At
8 Brown's suggestion, this investor withdrew \$10,000 from his 401(k) retirement account. *Id.* at ¶ 6.
9 He also borrowed an additional \$50,000 by taking out an equity line of credit on his home. *Id.* at ¶ 7.
10 He invested the money with Brown. *Id.* at ¶¶ 7-8, Ex. 1. In part as a result of Brown's failure to pay
11 this investor the promised returns on his investment, the investor had to file for bankruptcy. *Id.* at ¶
12 17.

13 **2. Brown Misappropriated Client Funds.**

14 From 2000 to at least 2007, Brown raised more than \$20 million in investments from his
15 clients through his Trebor Company investment programs. Pendrey Decl. Exs. 10-15, 28-32, 37-43.
16 Brown's clients deposited their investment money into multiple accounts Brown used, including his
17 personal accounts, a Trebor Company account, and an account held in the name of WISE. *Id.*
18 Although Brown promised his clients that he would invest their money in the stock market, Brown
19 never even opened a Trebor Company brokerage account. Instead, he helped himself to millions of
20 dollars of client money to pay for lavish personal expenses. *Id.* Brown frequently used limousine
21 services that were unrelated to business, such as shopping excursions with girlfriends or outings to
22 professional football games and concerts. Whitfield Decl., ¶ 4, Ex. 1. Brown also used his clients'
23 investment money on repairs on his Ferrari, expensive clothes, hotels, and restaurants. Pendrey
24 Decl., Exs. 10-15, 23 (55:23-56:11), 28-29, 31, 37-38, 43.

Brown used his clients' investment money to pay so-called "employees," which included family members.¹ Pendrey Decl., Ex. 10. For example, Brown paid his son approximately \$70,000, and gave about \$35,000 each to his sister and another family member (either his mother or sister, who have the same name). *Id.* Although Brown's son did some work researching stocks for Trebor Company, Brown didn't use that work to guide investment decisions. *Id.* at Ex. 23 (28:18-29:8). Brown also used investment money to support his son and his son's children for several years by providing them monthly gifts of approximately \$3,000 to \$4,000 for living expenses. *Id.* (65:10-18). Although Brown transferred a little over \$4.2 million of his clients' investment money to his personal brokerage account, he spent a substantial portion of this money on personal expenses, including his Ferrari, expensive clothes and hotels. *Id.* at Exs. 31, 43. In a September 2000 newspaper article about himself that he often distributed to potential investors, Brown claimed to be a humble man who was so modest he didn't own a car and often took the bus. Bunch Decl., Ex. 1. Yet, soon after he obtained client money, Brown began driving a Ferrari Testarossa luxury sports car. Bunch Decl., ¶ 4, Ex. 1; Pendrey Decl., Ex. 2 (51:13-52:2).

Brown used millions of dollars of investment money to make purported "profit" payments to other favored clients, although Brown never actually invested most of their money. Pendrey Decl., Exs. 24-26, 28-29, 31, 37-43. Thus, in many cases, money that came in from newer clients was simply transferred to the accounts of other clients in a Ponzi-like scheme. *Id.* For example, in September 2005, Brown transferred money from a client directly to Brown's son's bank account, and Brown instructed his son to pay the money to other clients without ever investing the money. *Id.* at Exs. 23 (44:25-45:9, 54:1-11), 24-26.

3. Brown Lied To Investors About What Happened To Their Money.

Brown never told investors that he spent their money on himself or transferred it to other investors. To the contrary, Brown told his clients in writing that their investments were earning the

¹ Brown did not use fees collected for providing investment advice, nor did he use purported profits to pay these so-called salaries to family members. Rather, investors transferred money directly to Brown's bank accounts, and Brown subsequently transferred the money to family members. Pendrey Decl., Exs. 10, 24-26, 28-29, 31, 37-43.

1 returns he had promised. Bunch Decl., ¶ 14, Ex. 13; Pendrey Decl., Ex. 7. During 2001 to 2005,
2 Brown directed an assistant to prepare and send investors account statements that falsely told them
3 they were earning returns as high as 13.1% quarterly. Pendrey Decl., Exs. 7, 9 (19:10-22:7), 11.
4 Similarly, clients who invested in the 24-Month High Yield program were sent statements showing
5 returns of up to 24% every 4 months. *Id.* at Exs. 9 (19:10-22:7), 12. Investors in the Double program
6 were sent statements showing that their account values had doubled in the time period Brown
7 promised. *Id.* at Ex. 5. Because Brown and Trebor Company had not actually invested the clients'
8 money, in reality, Brown's clients had not earned the returns reflected in Brown's false account
9 statements.

10 As a result of the false account statements, many investors "rolled over" their investments to
11 other programs, or purportedly reinvested their profits so that they would double again. Pendrey
12 Decl., Exs. 5-6. At the time his clients "reinvested" their "profits," Brown never told them he had
13 spent their original principal on personal expenses, on "salaries" to family members or on purported
14 "profit" payments to other investors. Moreover, as a result of the false promises Brown made and the
15 false account statements he provided to his clients, investors continued to tell friends and family
16 about Brown, which attracted even more investors to his fraudulent scheme.

17 By 2005, Brown was unable to pay his clients their purported profits, so he attempted to quell
18 concern about the lack of payments by lying again to investors. He promised several times in letters
19 addressed to a group of investors that checks would be sent out by a certain date, and then when the
20 date passed without investors having received any money, he would make up an excuse and promise
21 a new date. Bunch Decl., Exs. 18-20; McCombe Decl., Exs. 4-5; Whitfield Decl., Ex. 6-7; Pendrey
22 Decl., Ex. 21. Brown continues to promise investors that their money is coming. In letters to and
23 conversations with investors, Brown concocted elaborate excuses about what had happened to their
24 money. For example, Brown told clients in a letter that he would be "dissolving" Trebor Company
25 due to the difficulties that he was encountering in getting their money "due to the Patriot Act."
26 Pendrey Decl., Ex. 16. In August 2006, he again wrote a letter to investors claiming the Patriot Act
27 had made it "more than impossible" to keep his promises. McCombe Decl., Ex. 4; Whitfield Decl.,
28

1 Ex. 6. In the letter, Brown stated, "You must know that I have never lost any of your capital, nor will
2 I now." *Id.*

3 Brown told clients a variety of stories to explain the delay in getting their money back. For
4 instance, Brown said he had moved their money to an investment in gold and silver, which
5 supposedly explained why there would be a delay in investors getting their money back. Bunch
6 Decl., ¶ 22. Also, Brown claimed that he was investing overseas with a group of ministers and even
7 gave investors a phone number to call where they could listen to him on a conference call discussing
8 the supposed investment. *Id.* at ¶ 21. He also informed investors that he had bought an island and
9 would be selling it for a fortune, or alternatively, that investors could visit the island in their luxurious
10 retirement. *Id.* at ¶ 22.

11 It is likely that Brown told his clients these stories as an explanation as to why he could not
12 pay investors back immediately, instead dangling the prospect of even greater profits in the near
13 future. However, after telling these fanciful stories, Brown never repaid the investors. Bunch Decl.,
14 ¶ 22; McCombe Decl., ¶ 12.

15 4. Brown Refused to Testify.

16 The Commission's staff served Brown with a subpoena requiring him to appear and provide
17 testimony related to his investment advisory business. Pendrey Decl., ¶ 2. Brown refused to answer
18 questions about his investment qualifications, Trebor Company, solicitation of investors, his
19 investments, and misappropriation of investor funds based on his Fifth Amendment privilege against
20 self-incrimination. *Id.* He refused to produce documents to the Commission's staff. *Id.* at ¶ 3.
21 Brown even asserted through his counsel that he did not have responsive documents despite the fact
22 that he had Trebor Company's records removed from the garage of a former employee several
23 months earlier. *Id.* at ¶ Ex. 1, Ex. 8 (42:20-44:5). In addition, after Brown appeared before the
24 Commission and invoked his Fifth Amendment privilege, Brown told investors that he met with the
25 Commission's staff with his lawyer and the Commission "cleared" him of any wrongdoing. *Id.* at ¶
26 24, Ex. 35.

C. Relief Defendants Received Investor Funds.

WISE and CDC received and possess money or other assets through defendant Brown and Trebor Company's fraudulent scheme, material misrepresentations and omissions, and have no legitimate claim to them. Pendrey Decl., Exs. 25, 32-33. WISE and CDC are controlled by Eddings. *Id.* at ¶ 6, Exs. 32-33. At Brown's direction, investors deposited approximately \$8.5 million to an account held in the name of WISE from 2005 and 2007. *Id.* at ¶¶ 17, 21, Ex. 27, 32; Bunch Decl., ¶ 12, Ex. 8. Eddings is the only signatory for the account. *Id.* During this time, Eddings transferred more than \$240,000 from the WISE account to a CDC account, which he also controls. *Id.* at ¶ 22, Ex. 33. In September 2005, Brown used investor money to cause cashier's checks to be written to CDC totaling more than \$135,000. *Id.* at ¶ 16, Ex. 25. In 2005, Brown transferred \$10,000 to Eddings. *Id.* at ¶ 25, Ex. 36. Also in 2005, Brown caused his son to transfer \$41,250 of investor money to Eddings. *Id.*, at ¶¶ 15-16, Exs. 23 (49:17-50:4), 26.

The Commission's staff served Eddings with a subpoena requiring him to appear and provide testimony related to money received from the defendants. Pendrey Decl., Ex. 7. Eddings refused to answer questions based on his Fifth Amendment privilege against self-incrimination. *Id.*

D. Brown Continues To Solicit Investments.

As recently as June 2008, Brown has solicited money from new investors. Pendrey Decl., ¶ 26. Indeed, Brown told an investor in June 2008 that the investor would earn returns of 30% to 40% per month as a result of Brown investing the money in stocks. *Id.* Brown also has promised the investor a 10% commission on all the money Brown raises from other investors referred to Brown by that investor. *Id.*

In addition, Brown has a new program instructing investors to open brokerage accounts in their own names and then provide Brown their online user identification and passwords to allow Brown to trade online in the investors' accounts. Pendrey Decl., ¶ 26, Ex. 19. Brown offered to split any profits with investors. *Id.* at Ex. 19. Documents obtained by the Commission's staff suggest that Brown has been trading securities through brokerage accounts held by TD Waterhouse Canada, Inc., a broker-dealer based in Ontario, Canada. *Id.* at Ex. 20. Although Brown has been losing money by trading in these accounts, he is making risky trades on margin. For example, one account in which

1 Brown was trading had a balance in February 2008 of approximately \$740,000. *Id.* Brown stated to
 2 an assistant that the balance “needs to be \$1,303,000 in 2.5 weeks” (emphasis original) just to break
 3 even on his trading. *Id.*

4 **III. LEGAL ARGUMENT**

5 **A. The Legal Standard for Ordering Temporary Relief.**

6 The Commission seeks an order from the Court providing for a temporary injunction and
 7 restraining order, pursuant to Section 21(d) of the Securities Exchange Act of 1934 (“Exchange
 8 Act”), which provides in relevant part:

9 Whenever it shall appear to the Commission that any person is engaged or is about to
 10 engage in acts or practices constituting a violation of any provision of this title, [or] the
 11 rules or regulations thereunder, . . . it may in its discretion bring an action in the proper
 12 district court of the United States . . . to enjoin such acts or practices, and upon a proper
 showing a permanent or temporary injunction or restraining order shall be granted
 without bond.

13 15 U.S.C. § 78u(d). *See also* 15 U.S.C. § 80b-9(d).

14 When the Commission seeks a temporary restraining order pursuant to these statutes, relief is
 15 appropriate upon a showing of *either*: (1) a likelihood of success on the merits and the possibility of
 16 irreparable injury; *or* (2) serious questions going to the merits and the balance of hardships tipping
 17 sharply in the Commission’s favor. *Southwest Voter Registration Educ. Project v. Shelley*, 344 F.3d
 18 914, 917 (9th Cir. 2003) (*en banc*). Where, as here, the Commission brings an action to safeguard the
 19 public interest and to enforce the federal securities laws, irreparable injury should be presumed. *See*
 20 *United States v. Odessa Union Warehouse Co-Op*, 833 F.2d 172, 174-75 (9th Cir. 1987) (holding
 21 irreparable injury presumed in federal agency action for injunctive relief); *Navel Orange Admin.*
 22 *Comm. v. Exeter Orange Co.*, 722 F.2d 449, 453 (9th Cir. 1983) (same). The Commission is not
 23 required to prove irreparable injury or the inadequacy of legal remedies, as may be required of a
 24 private litigant moving pursuant to Federal Rule of Civil Procedure 65. Instead, the relief should be
 25 granted when the Commission meets the statutory requirement of showing a likelihood of continued
 26 violations of the securities laws, since the agency appears “not as an ordinary litigant, but as a
 27 statutory guardian charged with safeguarding the public interest.” *See SEC v. Mgmt. Dynamics, Inc.*,
 28 515 F.2d 801, 808 (2d Cir. 1975).

As discussed below, the Commission's evidence establishes that the defendant has violated, and that there is a reasonable likelihood that defendant will continue to violate, the securities laws unless he is restrained and enjoined. In particular, absent a restraining order and the other relief sought by the Commission, defendant will likely continue to misappropriate investor funds and deceive current or new investors to obtain their money under the guise of trading in securities.²

B. Defendant's Deception, Misrepresentations and Omissions, and Misappropriation of Investor And Client Funds Constitute Securities Fraud.

1. The Antifraud and Fiduciary Provisions of the Securities Laws

The antifraud provisions of the Exchange Act, Section 10(b) and Rule 10b-5, prohibit fraud in connection with the purchase or sale of securities. 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5. Conduct prohibited by these provisions includes the use of deceptive devices, or the making of any untrue statement of a material fact, or omitting to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading. 17 C.F.R. § 240.10b-5.

To constitute fraud in connection with the purchase or sale of securities, the deception, misstatement or omission must be made with "scienter," that is, knowingly, and must be "material." *See Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988) (quoting *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976)) (setting forth the materiality standard); *Aaron v. SEC*, 446 U.S. 680, 695 (1980). The Ninth Circuit has expressly held that recklessness satisfies the scienter requirement. *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, 1568-69 (9th Cir. 1990) (en banc). Materiality is established where there is a substantial likelihood that a reasonable investor would consider the information important in making an investment decision. *TSC Indus.*, 426 U.S. at 449. *See SEC v. Murphy*, 626 F.2d 633, 653 (9th Cir. 1980) ("Surely the materiality of information relating to financial condition, solvency and profitability is not subject to serious challenge."); *Koehler v.*

² In hearing the Commission's motion, due to the exigencies, the Court has discretion to accept hearsay and other evidence that might be inadmissible at trial. *Republic of the Philippines v. Marcos*, 862 F.2d 1355, 1363 (9th Cir. 1988).

Pulvers, 614 F. Supp. 829, 842 (S.D. Cal. 1985) (material information includes, at a minimum, “accurate information on the use of investor funds”).³

The same conduct that violates the antifraud provisions of the Exchange Act, may also constitute a breach of an investment adviser’s fiduciary duties under Section 206 of the Investment Advisers Act of 1940 (“Advisers Act”). 15 U.S.C. §§ 80b-6. *See SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 191-92, 194, 84 S.Ct. 275, 11 L.Ed.2d 237 (1963) (advisers owe fiduciary duty to deal with their clients in utmost good faith and complete candor). Thus Section 206 of the Advisers Act makes it unlawful for any investment adviser, directly or indirectly:

(1) to employ any device, scheme, or artifice to defraud any client or prospective client; [or]

(2) to engage in any transaction, practice or course of business which operates as a fraud or deceit upon any client or prospective client.

15 U.S.C. §§ 80b-6(1), (2).⁴ The statute reflects Congress’s “recognition of the delicate fiduciary nature of an investment advisory relationship, as well as a congressional intent to eliminate, or at least to expose, all conflicts of interest which might incline an investment adviser – consciously or unconsciously – to render advice which was not disinterested.” *Capital Gains*, 375 U.S. at 191-92 (internal quotations and footnote omitted). While the first subsection of the statute requires proof of knowing or reckless conduct, the second does not “require proof of intent to injure or actual injury to the client.” *Id.* at 195.

³ The “in connection with” requirement is satisfied if a scheme to defraud (whether or not accompanied by a particular misrepresentation or omission) coincides with the sale (or purchase) of securities. *SEC v. Zandford*, 535 U.S. 813, 820, 122 S.Ct. 1899, 153 L.Ed.2d 1 (2002); *Simpson v. AOL Time Warner Inc.*, 452 F.3d 1040, 1050-51 (9th Cir. 2006).

⁴ An “investment adviser” includes “any person, who for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities.” 15 U.S.C. § 80b-2(a)(11). Misappropriation of investor assets constitutes “compensation.” *See, In the Matter of Alexander V. Stein*, 59 S.E.C. Docket 1115, 1995 WL 358127 (June 8, 1995).

2. Brown Fraudulently Misappropriated Funds and Lied to Clients.

Brown repeatedly and purposefully misappropriated client funds for his own uses. His conduct constitutes fraud under the Exchange Act, and a breach of his duty as an investment adviser to his clients. As the Supreme Court discussed in *SEC v. Zandford*, using the purchase or sale of securities as an excuse to write unauthorized checks against clients' brokerage accounts is properly viewed as a fraudulent course of business. 535 U.S. at 820, 122 S.Ct. at 1904 (citing *United States v. Dunn*, 268 U.S. 121, 131, 45 S.Ct. 451, 69 L.Ed. 876 (1925)). Similarly, conduct that includes commingling client assets with the adviser's assets, or operating a ponzi scheme, or otherwise secretly profiting at the expense of the client, violates an adviser's fiduciary duty to his clients and operates as a fraud upon them. *Capital Gains*, 375 U.S. at 196-97. See *United States v. Elliott*, 62 F.3d 1304 (11th Cir. 1995), *amended* 82 F.3d 989, *certiorari den.* 117 S.Ct. 161, 519 U.S. 859, 136 L.Ed.2d 105 (ponzi scheme violated Section 206); *SEC v. Slocum, Gordon & Co.*, 334 F. Supp.2d 144 (D.R.I. 2004) (commingling clients' assets with firm's); *Vernazza v. SEC*, 327 F.3d 851, 859 (9th Cir. 2003); *Mayfield v. First Nat. Bank of Chattanooga*, 137 F.2d 1013, 1018 (6th Cir. 1943) (holding that fiduciary has a duty to provide detailed status report to clients of changes in assets under the fiduciary's control).

Furthermore, Brown engaged in repeated lies, both to attract investors and to cover up his scheme. Brown misrepresented his credentials and experience, he falsely downplayed the risks of trading in securities, and he made false promises guaranteeing tremendous profits. He also gave clients falsely inflated account values, and omitted to inform clients that he was stealing their money to use on lavish personal expenses and to pay family members. Brown also failed to disclose that he used money raised from newer investors to pay so-called profits to other clients without having actually invested the money entrusted to him by his clients. Such misrepresentations and omissions amount to fraud.

Brown acted with scienter. Defendant's intent to deceive may be inferred from the very nature of the scheme Brown perpetrated – using one client's money to repay another investor who sought a return on his investment. See *Webster v. Omnitron Int'l*, 79 F.3d 776, 785 (9th Cir. 1996) (“[a] jury could rationally conclude that the promotion of a pyramid scheme demonstrates the

1 necessary fraudulent intent"). His fraudulent intent is also evidenced by his refusal to answer
2 questions in testimony on the grounds that he might incriminate himself. *See SEC v. Colello*, 139
3 F.3d 674, 677 (9th Cir. 1998) ("Parties are free to invoke the Fifth Amendment in civil cases, but the
4 court is equally free to draw adverse inferences from their failure of proof."); *SEC v. Trabulse*, 526 F.
5 Supp. 2d 1001, 1007, fn. 4 (N.D. Cal. 2007) (denying motion to dismiss SEC complaint for lack of
6 particularity, finding that the "Court is entitled to make an adverse inference" from defendant's
7 invocation of his Fifth Amendment privilege).

8 Brown's deception and his misrepresentations and omissions were also material. Brown's
9 misrepresentations attracted new investors, lulled existing clients, and in general, caused Brown's
10 fraud to balloon over a period of several years until he had harmed hundreds of clients by stealing
11 more than \$20 million. Given the pervasiveness of his fraud, his misrepresentations, omissions and
12 deception are clearly material. *SEC v. Murphy*, 626 F.2d at 653.

13 **C. Injunctive and Related Relief Is Necessary and Appropriate.**

14 **1. Restraining Order and Preliminary Injunction**

15 As set forth above, the Commission's evidence of Brown's fraud to date establishes a
16 likelihood of success on the merits, and the further likelihood that Brown will continue to engage in
17 such conduct unless restrained and enjoined. Further, although irreparable injury should be
18 presumed, the evidence makes clear that without such an order, Brown will continue to solicit money
19 from current and potential clients. Moreover, existing investors will be harmed through the further
20 loss of their funds. To date, Brown has stolen more than \$20 million, and he should not be permitted
21 to take any more. Thus, the statutory requirements both for a restraining order, and a permanent
22 injunction, are readily met. *Southwest Voter Registration Educ. Project v. Shelley*, 344 F.3d at 917.

23 Accordingly, the Commission requests that the Court enter an order prohibiting the defendant
24 from violating the antifraud provisions set forth above. In order to address the specific harm to
25 clients in this case, and to maintain the status quo, the Commission requests that the Court further
26 restrain and enjoin the defendant from placing any order for securities for his own or another person's
27 account, or from making any transfers of money into or out of or otherwise exerting his control or
28

1 influence over the brokerage or bank accounts of other persons as set forth in the Commission's
2 proposed order.

3 **2. Asset Freeze**

4 An order freezing bank and, potentially, brokerage accounts in the defendants' names, the
5 relief defendants' names, and in the names of entities that the defendants or relief defendants own and
6 control, is necessary to protect any remaining investor funds and to prevent their immediate
7 dissipation. This Court has the inherent equitable authority to issue ancillary relief in Commission
8 injunctive actions, including the freezing of accounts or assets. *SEC v. Hickey*, 322 F.3d 1123, 1131-
9 32 (9th Cir. 2003); *SEC v. Wencke*, 622 F.2d 1363, 1369 (9th Cir. 1980); *SEC v. Int'l Swiss Invs.*
10 *Corp.*, 895 F.2d 1272, 1276 (9th Cir. 1990). An asset freeze is appropriate to prevent waste and
11 dissipation of assets while litigation is pending, and to ensure their availability for restitution and
12 disgorgement. *E.g., FTC v. H.N. Singer, Inc.*, 668 F.2d 1107, 1112-13 (9th Cir. 1982). Where the
13 Commission has shown that it is likely to succeed on the merits, the mere possibility of dissipation of
14 assets is sufficient to warrant an asset freeze; the Commission does not need to show that dissipation
15 has occurred or is imminent. *FSLIC v. Sahni*, 868 F.2d 1096, 1097 (9th Cir. 1989).

16 A freeze of Brown's accounts is especially important under these circumstances. The
17 Commission has identified 9 bank accounts opened in defendants' or relief defendants' names that
18 have already received investor funds. At times, Brown has maintained and funded brokerage
19 accounts in his name. Also, Brown has been trading in brokerage accounts in Canada, which appear
20 to be held in the names of others. Brown should not be given the further opportunity to hide or
21 dissipate additional assets.

22 Eddings received investor funds and controls WISE and CDC accounts that have received
23 investor funds. In addition, when asked about the receipt of funds and the receipt of investor funds
24 by WISE and CDC, Eddings asserted his Fifth Amendment privilege and refused to answer any
25 questions. *See SEC v. Hickey*, 322 F.3d at 1131-32 (holding that court could freeze third party assets
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1 to protect asset freeze and disgorgement order against defendant).⁵ Accordingly, the Commission
2 requests that the Court also freeze accounts opened in the names of the relief defendants.

3 The Court should also impose an asset freeze upon relief defendants' assets. A freeze on
4 relief defendants' accounts is appropriate where the relief defendant has received ill-gotten gains to
5 which the relief defendant does not have a superior legal right. *SEC v. Cavanagh*, 155 F.3d 129, 136
6 (2d Cir. 1998). So far, the Commission has identified 2 accounts in Eddings' name, and a WISE
7 account and several CDC accounts.

8 **3. Accounting**

9 The Commission requests that this Court enter an order requiring defendants to submit a
10 verified accounting for the purpose of identifying: (i) the location and disposition of all funds
11 received from clients; (ii) the location and disposition of all accounts opened in the names of clients;
12 and (iii) the location and value of all personal or client (or other) assets presently held by defendants
13 (and relief defendants), or under the defendants' or relief defendants' control or over which they may
14 exercise actual or apparent authority. This accounting will assist the Court to determine the scope of
15 the fraudulent scheme and the appropriate scope of the asset freeze order. In addition, an order for an
16 accounting will make it more difficult for defendants to conceal assets in anticipation of a final order
17 requiring disgorgement and civil penalties. *See, e.g., SEC v. Int'l Swiss Invs. Corp.*, 895 F.2d 1272,
18 1274 (9th Cir. 1990); *FTC v. H.N. Singer*, 668 F.2d at 1114.

19 **4. Repatriation**

20 Repatriation of assets held by defendants outside the United States will further protect
21 investors from dissipation of assets. *See, SEC v. Bankers Alliance Corp.*, Civ. A. No. 95-0428
22 (D.D.C. May 5, 1995) (Friedman, J.), 1995 WL 590665, (Commission sought enforcement of order
23 granting broad relief, including order to repatriate funds). Brown's use of Canadian brokerage
24 accounts held in the names of others makes repatriation appropriate in this case. Accordingly, the

25 ⁵ *See also Steffen v. Gray, Harris & Robinson*, 283 F. Supp. 2d 1272, 1282-83 (M.D. Fla. 2003)
26 (following *Hickey* and ruling that asset freeze and disgorgement order reached off-shore trusts that
27 were not owned by defendant, but were nonetheless under his control); *In re San Vicente Med.*
28 *Partners, Ltd.*, 962 F.2d 1402, 1406 (9th Cir. 1992) (ruling that district court could extend
receivership to any entity under defendant's control).

1 Commission requests that the Court order the defendants to repatriate all investor assets as set forth in
2 the Commission's proposed order.

3 **5. Expedited Discovery**

4 Because of the urgent need for relief to prevent dissipation of assets, the Commission also
5 seeks expedited discovery to subpoena documents relating to the fraudulent scheme, in order to
6 determine the extent of the fraud, the disposition of investor funds to date, and to preserve any
7 remaining funds. The Commission will seek discovery, including depositions and documents, from
8 defendants and the relief defendants, as well, in order to obtain additional facts related to the fraud.
9 Accordingly, the Commission requests that the Court permit discovery to begin immediately, before
10 the parties have conferred in accordance with Rule 26(f) of the Federal Rules of Civil Procedure.

11 **6. Order Preventing Alteration or Destruction of Documents**

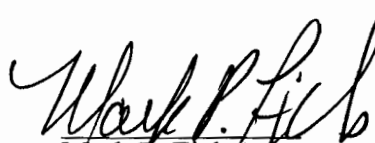
12 To protect all remaining documents necessary for full discovery in this matter, the
13 Commission seeks an order preventing the alteration or destruction of documents. To this point, the
14 Commission has not been provided with access to all the relevant documents. Brown has not
15 produced many of the incriminating documents, such as bank records and his client agreements. In
16 addition, Brown may have hidden or destroyed relevant documents, which he removed from a former
17 employee's home. An order to preserve documents is therefore appropriate to protect the integrity of
18 this litigation. *SEC v. Chemical Trust*, [2000 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 91,291, at
19 95,642 (S.D. Fla. 2000).

20 **IV. CONCLUSION**

21 For the foregoing reasons, the Commission respectfully requests that this Court grant the
22 relief requested.

23 Dated: July 23, 2008

Respectfully submitted,

24
25 

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SECURITIES AND EXCHANGE
COMMISSION